

Middle Market Companies Still Struggle to Access Capital

We are coming up on the anniversary when the credit market seized up and stopped working in a logical fashion. Much has been done on the part of the Fed to keep credit flowing and to save large financial institutions from failure.

The good news is that credit has started flowing again. The bad news is that middle market companies are still finding it difficult to raise capital through traditional channels.

Stronger banks such as Wells Fargo, Chase and others continue to actively lend. "Our approach to lending at Wells Fargo Business Credit has not changed. We continue to make asset-based loans to middle market companies who fit our traditional lending profile," commented Robin Oertel, vice president, business development officer with Wells Fargo Business Credit. "As always, we look through new business opportunities thoroughly, and work with our customers to find alternative solutions that reflect the unique history and potential of each business."



PNC Bank, a national bank that makes asset-based loans in the \$8 million to \$30 million range is trying to do the same. "Our challenge is that qualified borrowers are harder to find," according to Drew Conneen, senior vice president at PNC Business Credit. "The loan criteria have changed a bit, but not enough to make a significant impact."



What has made an impact for middle market companies seeking capital has been the toll the economy has taken on their business and industries. This can be seen in two key areas -- financial results and asset valuation. Company financial results are down, in some cases more than 30%. And, company appraised asset values are down, including inventories, plants and other real estate assets.

Lower performance and valuations have impacted existing borrowers as well. Many are finding it difficult to renew their loans because companies don't qualify for the same amount of money.

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Strategic Option for Middle Market Companies Without Access to Credit

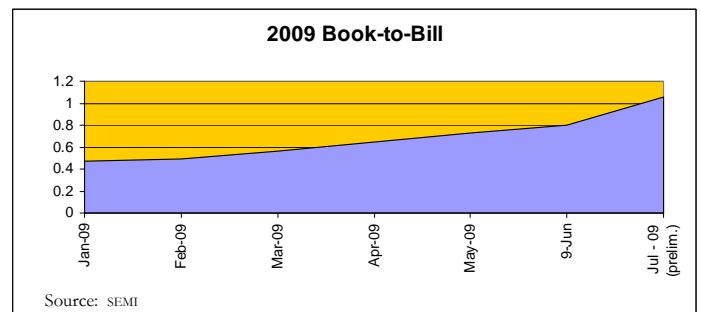
Middle market semiconductor and electronics companies have caught a tough break lately. Sales are down significantly, margins have been squeezed beyond sustainable levels and working capital has all but disappeared. Fortunately, bad cycles come to an end and it looks like there is a light at the end of the tunnel. Things are not as bad these days and recent reports suggest the semiconductor market has hit bottom and will improve in the second half of this year.

Today's environment presents tremendous opportunity for enterprising companies to take significant strategic action, such as acquiring companies, and position for the next growth cycle. The challenge is how to acquire companies without cash or access to credit.

(See page 2, col. 1)

Book-to-Bill Ratio Above Parity, First Time Since January 2007

North American-based manufacturers of semiconductor equipment posted \$569.7 million in orders in July 2009 (three-month average basis) and a book-to-bill ratio of 1.06, according to the July 2009



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Strategic Option *(From page 1, col. 2)*

In addition, acquisition candidates are shying away from being purchased due to current depressed market valuations. Management is looking for an exit strategy at a stronger valuation than the market will bear.

“A merger and divestiture strategy can be very powerful given today’s market constraints,” according to Loren Lancaster, managing director of Core Capital Group’s Electronics and Semiconductor Group. “It solves both the cash and valuation problems.”



Typically, it takes three to five years from the bottom of a recessionary trough for the market to fully recover and valuations to peak. Consequently, taking action today puts a merged entity in position to exit when the market is reaching its zenith.

The fundamentals of a merger and divestiture strategy have not changed significantly. The goal is to roll up synergistic and like-minded companies through a series of mergers, reduce redundant functions improving profitability and then exit at a higher multiple. This also means divesting parts of the business that are not synergistic, but came along with the merger.

What has changed is the complexity of the market.

“A successful outcome requires dealing with equal currency,” commented Lancaster. “Proper valuation modeling is critical, and can be difficult to get right given the significant changes the market has undergone.”

A proper merger and divestiture strategy involves starting with a detailed plan, sourcing many candidates and vetting the best matches, relevant valuation modeling reflecting today’s market, creating the story and being very proactive in negotiating a complex series of transactions.

The timing is right for a properly executed merger strategy. It solves the cash and access to credit issues, and allows companies to exit in a stronger market position with much higher multiples than today’s market will allow.

Book-to-Bill *(From page 1, col. 2)*

Book-to-Bill Report published by SEMI. A book-to-bill of 1.06 means that \$106 worth of orders were received for every \$100 of product billed for the month.

“The increases in both bookings and billings reported by North American equipment manufacturers boosted the book-to-bill ratio above parity for the first time since January, 2007,” said Stanley T. Myers, president and CEO of SEMI. “Even with that improvement, however, bookings remain significantly below year-ago figures.”

The SEMI book-to-bill is a ratio of three-month moving averages of worldwide bookings and billings for North American-based semiconductor equipment manufacturers.

Capital *(From page 1, col. 1)*

Larger more credit worthy companies have recently turned to the bond market at significant levels. Non-financial companies have issued \$1.1 trillion-worth of bonds so far this year, according to Dealogic. That figure already exceeds the annual record of \$898 billion set in 2007. The *Wall Street Journal* reports that with investor demand for corporate debt expected to stay solid, financing costs will remain low for high-grade firms.

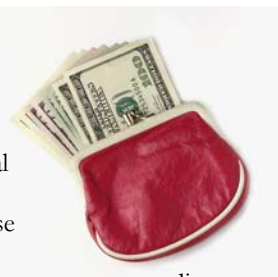
Private equity (PE) groups have taken an unusual step to raise capital. Some have turned to the public market to boost returns necessary to entice investors back into their funds. *BusinessWeek* recently reported that private equity owners are currently the most active participants in the IPO Markets which have improved dramatically since last winter. PE groups are using an IPO strategy to generate returns for their investors and are using cash from an IPO to lighten the debt load at highly-leveraged companies in their portfolios.

Many traditional banks are known for being conservative. “What’s important to remember is that specialty lending, such as asset-based lending, factoring, and purchase order financing are alternative financing solutions to traditional banking relationships,” Oertel said.

Today there are fewer non-bank lenders and there doesn’t appear to be any *new* financing options being offered to bridge the gap created by under-performing companies and traditional lender criteria. Consequently, many middle market companies have had to change and adapt to working with less available capital. “We have seen our outstanding loans drop in the past year due to increasing uncertainty causing management to elect to borrow less, postpone capital projects and conserve more cash,” Conneen said.

Conneen expects the economy to hit bottom in the fourth quarter of this year if it has not already done so and improve going into next year. In the meantime, he advises companies to manage the business well and make sure to avoid tripping any loan covenants on existing loans.

The best news middle market electronic and semiconductor companies can hear is that people are spending again. Consumers recently got a shot in the arm. The S&P/Chase-Shiller index of national house prices rose by 2.9% in the second quarter of this year, the first such increase since the spring of 2006. However, unemployment continues to be a drag on consumer spending.



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